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IN THE

Supreme Court of the United States

October Term, 1982

No. 82-434

NORTHERN UTILITIES, INC., a Wyoming corporation,
Petitioner,

v.

KERR-McGEE CORPORATION, a Delaware corporation,
Respondent.

NORTHERN UTILITIES, INC., a Wyoming corporation,
Petitioner,

v.

AMOCO PRODUCTION COMPANY,
a Delaware corporation and
PHILLIPS PETROLEUM COMPANY,
a Delaware corporation,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF OF RESPONDENT, AMOCO PRODUCTION COMPANY, IN OPPOSITION TO PETITION FOR CERTIORARI

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STATEMENT OF THE CASE

This case involves the interpretation of an intrastate gas sales contract between Respondent Amoco Production Company (Amoco) and Petitioner Northern Utilities, Inc. (Northern), and more particularly, the third-party favored nations clause in the contract. Such clauses are common in long-term gas sales contracts. The effect of the clause is to automatically escalate the price to be paid under the contract to the highest price being paid by any buyer to another seller in a given area. The purpose of the clause is to allow the purchaser to secure a long-term supply of natural gas while protecting the seller from the dangers inherent in long-term contracts at fixed prices.

The District Judge, after a trial to the Court, made his findings of fact and concluded that the third-party favored nations clause was void as against public policy and as unconscionable when made. He thereafter entered judgment against Amoco in the sum of $59,603,631.00 for reimbursement of payments previously made pursuant to said clause, and ruled that the clause was void and that the contract would remain otherwise in force and effect.

Like decisions were entered in favor of Northern and against Kerr-McGee Corporation (Kerr-McGee) and Phillips Petroleum Company (Phillips). Kerr-McGee and Phillips appealed these decisions and the three appeals were consolidated.

The Court of Appeals for the Tenth Circuit reversed the decision of the trial court. The Court of Appeals held that Northern had not demonstrated that the third-party favored nations clause was unconscionable under Wyoming law and that the clause was not contrary to either federal or Wyoming public policy.

STATEMENT OF FACTS

On November 11, 1957, the predecessor of Amoco, Pan American Petroleum Corporation, entered into a Gas Sales Contract with Northern for the natural gas produced in Wyoming from the Beaver Creek field. The Producers of the gas in the Beaver Creek field are Amoco, Kerr-McGee and Phillips, with Amoco acting as operator. Like contracts were entered into between Northern and Kerr-McGee and Northern and Phillips. The contract's term was for twenty (20) years from the date of first delivery, and the price to be paid by Northern to Amoco was based on "each one thousand (1,000) cubic feet of gas taken." The base price per year of one thousand cubic feet (Mcf) is set forth in Article 5 and was subject to adjustment for inflation or deflation as provided in Article 7.

Article 6, entitled "*Favored Nations Clause*," provides for a price increase in accordance with a two-party favored nations clause and concluded:

> It is the intention hereof that the price to be paid Pan American hereunder shall at all times be equal to the higher of the following: (a) the price payable under Article 5 of this contract, as such price may have been changed by Article 7, or (b) the highest price paid by Northern to a producer of gas in the State of Wyoming.

By Article 3 of the contract, Northern irrevocably dedicates and commits the gas to its Wyoming markets, and the Article, after defining "Wyoming markets," provides:

> It is the intent hereof that the dedication set forth herein shall be strictly observed and maintained in conformance with the further provisions of this article and contract, to the end that the intrastate status of this sale shall at all times be maintained.

Northern was granted a preferential right to negotiate with Amoco "for a suitable contract and price covering" any excess gas Amoco had for sale during the term of the contract.

On April 7, 1970, Amoco, acting through Arles H. Barrett,[1] advised Northern that it had approximately sixty billion cubic feet of excess gas at Beaver Creek for sale, and, pursuant to Article 8 (d) of the Gas Sales Contract, invited Northern "to exercise your right to negotiate for the purchase of the additional gas quantity." Amoco desired to sell the excess gas during the remaining term of the agreement, that is, between 1970 and the end of 1977.

Northern, acting through Edwin Magagna,[2] accepted the invitation and between April of 1970 and October 1, 1970, Mr. Barrett, on behalf of Amoco and Mr. Edwin Magagna, on behalf of Northern, negotiated an amendment to the Gas Sales Contract. Each party presented oral and written proposals and drafts of the amended contract were being exchanged regularly. Northern did not want to take the excess gas during the term of the agreement, and negotiated for an extension of the term through 1990. The amendment was reduced to writing, dated October 1, 1970, and was executed by the parties. Article 5 (Base Price per Mcf) of the Gas Sales Contract was amended by adding thereto the base price per Mcf for the years 1979 through 1990.

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[1] Mr. Barrett has been an employee of Amoco and its predecessor since 1946. His formal education consists of two years of college. His experience is in the research department, field operations, gas measurement supervisor and a negotiator for sales of natural gas.

[2] Mr. Magagna was an attorney licensed to practice law in Wyoming with a number of years of experience in representing utilities. He was charged by Northern to negotiate on its behalf a written contract which would amend the 1957 agreement to reflect the acquisition of the additional gas.

Paragraph 4 of the amendment provides as follows:

> 4. The paragraph comprising present Article 6, Favored Nations Clause, is designated (a), and the following new paragraph (b) is added to said Article 6:
>
> '(b) From and after January 1, 1976, when the price to be paid by Northern to Pan American pursuant to the other provisions hereof is less than the sum of the price received for gas being sold in interstate commerce, by any producer within the State of Wyoming, except in the counties of Uinta and Lincoln, plus three cents per one thousand cubic feet (3¢/MCF), then Northern shall increase the price to be paid Pan American hereunder to a price equal to the price being received by such producer plus three cents per MCF.'

The last paragraph of the amendment required the submittal of the amended contract to the Public Service Commission of Wyoming for acceptance and filing. The amendment was delivered to the Public Service Commission of the State of Wyoming, accompanied by a statement of Northern prepared by Mr. Magagna to the Commission. That statement referred to the difficulty in obtaining long-term commitments and the advantages Northern believed it would receive under the amended contract. Thereafter, the Director, Utilities Department of the Public Service Commission of the State of Wyoming, advised Northern of the acceptance by the Commission. In 1973 like written amendments to their contracts were executed by Northern and Kerr-McGee and Northern and Phillips. These amendments were accepted for filing by the Public Service Commission.

In the year 1975, Northern was advised that the provision of 6 (b) of the Gas Sales Contract would be "triggered" as of January 1, 1976 by reason of the fact that prices being received by producers of gas in Wyoming per Mcf for sales in interstate commerce were exceeding the amount being paid to Amoco under the other provisions of the Gas Sales Contract. In December of

1975 Northern accordingly petitioned the Public Utilities Commission for an increase in rates. The Commission granted the increase. Amoco agreed to "phase in" the new prices until July 1, 1978 at which time the price escalator clause would be fully operative. Neither Kerr-McGee nor Phillips agreed to the "phased-in" prices.

As of December 1, 1978, the Natural Gas Policy Act came into effect, which limits the amount a producer may receive for the sale of intrastate gas to the lesser of the contract price and that which the producer could receive under Section 102 of the Act. The contract price (that is, the amount received by a Wyoming producer per Mcf for sales in interstate commerce plus three cents (3¢)) is higher than the Section 102 price. The ceiling price imposed by the Act is the amount due from Northern to Amoco.

In that it was receiving only the "phased-in" price for its gas, Kerr-McGee brought suit against Northern. In May of 1978, prior to the time when the prices were to be "phased-in," Northern brought suit against Amoco and Phillips. The two actions were consolidated for trial.

Northern initially claimed that Clause 6 (b) was ambiguous and contrary to public policy. On October 23, 1980, the trial court concluded that Clause 6 (b) was contrary to public policy and unconscionable. On March 23, 1982, the Court of Appeals for the Tenth Circuit reversed the decision of the trial court.

SUMMARY OF ARGUMENT

Contrary to Northern's suggestions, the decision of the Court of Appeals below properly interprets the public policy of the United States and the State of Wyoming. Further, the Court of Appeals followed the controlling decision on unconscionability rendered by the Wyoming Supreme Court in upholding the favored nations clause at issue herein. Therefore, the Court of

Appeals has rendered a decision which neither conflicts with a state court of last resort nor departs from accepted judicial procedure.

There exists no compelling reasons for this Court to review this case and the Petition for Certiorari should be denied.

ARGUMENT

I.

NORTHERN FAILED TO DEMONSTRATE THAT CLAUSE 6(b) WAS UNCONSCIONABLE AS A MATTER OF LAW.

Northern's contention that the Court of Appeals below failed to consider evidence which Northern relied upon at trial in asserting its claim of unconscionability is simply inaccurate. Each argument presented to this Court was raised by Northern in its briefs on appeal and addressed in oral argument. Further, in its opinion, the Court of Appeals explicitly acknowledged and rejected the reasons underlying the trial court's decision.

> The judge indicated that he found the price particularly offensive because it was unrelated to the cost of production, and was higher than the producers themselves could have received for the gas in an interstate sale. The producers could not qualify for the 'small producers' rate established for gas sales in interstate commerce, which was set at 130% of the ceiling rate established for large producers. *See* FPC Opinion No. 742 (August 28, 1975). However, paragraph 6 (b), by pegging the contract cost to the price received by *any* producer selling interstate gas, allowed the producers to receive the 'small producers' rate for interstate sales. Moreover, paragraph 6 (b) contains no vintaging distinction between old and new gas. The ceiling rates for old gas sold in interstate commerce are lower than those for new gas. *See American Pub. Gas Association v. FPC*, 567 F.2d 1016, 1033 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 907 (1978). Through the operation of 6 (b), therefore, the producers here could

> receive the new gas rate for old gas. *See Amoco Production Company v. Stauffer Chemical Company*, 612 P.2d 463, 466 (Wyo. 1980).

Court of Appeals Slip Opinion at 8-9, n. 7. Rather than ignore the evidence in the case, the appellate court correctly found it insufficient as a matter of law to void the contract. Therefore, the trial court's decision was reversed.

The Court of Appeals properly held in accordance with Wyoming law "that unconscionability is tested as of the time the agreement is made and not in accordance with hindsight." *In Re Estate of Frederick*, 599 P.2d 550, 556 (Wyo. 1979). The doctrine of unconscionability is "one of 'prevention of oppression and unfair surprise.'" *Bernina Distributors, Inc. v. Bernina Sewing Machines*, 646 F.2d 434, 440 (10th Cir. 1981). An increase in price has nothing to do with unconscionability. *Id.* The record below reflects that Clause 6 (b) resulted from months of negotiation between experienced businessmen, Mr. Magagna and Mr. Barrett, respectively, representing Northern and Amoco. Each side made concessions in order to strike a bargain with which each was satisfied in 1970. There is simply no evidence in the record of overreaching or superior bargaining power on the part of Amoco. After a period of two (2) years following the execution of the amended contract, Northern finally persuaded Kerr-McGee and Phillips to enter into identical contracts containing the Clause 6 (b) favored nations clause. Northern now seeks judicial intervention to be relieved from what it believes was an unwise bargain. Both Amoco and Northern are sophisticated parties. Each entered into the contract knowing full well that events beyond their control to occur in future years would dictate whether the contract, in hindsight, was well or ill-conceived. The Court of Appeals was correct in holding as a matter of law that Northern had failed to demonstrate unconscionability under Wyoming law.

II.

CLAUSE 6 (b) OFFENDS NEITHER THE PUBLIC POLICY OF THE UNITED STATES NOR THE STATE OF WYOMING.

In the area of production and sale of natural gas, national policy unquestionably has been codified in the National Gas Policy Act of 1978 (NGPA), 15 U.S.C. § 3300, *et seq.* The NGPA is a comprehensive regulatory scheme governing the maximum price which may be charged for the sale of all natural gas produced in the country. The NGPA imposed federal price controls on the intrastate market for the first time in 1978. Further, the NGPA permits the price under intrastate gas contracts to rise through the operation of indefinite price escalator clauses up to the maximum rate established by the Act. 15 U.S.C. § 3315.

Under the NGPA, the conflicting interest between producers and consumers have been balanced by Congress. *Pennzoil Company v. FERC*, 645 F.2d 360, 379 (5th Cir. 1981), *cert. denied*, 102 S. Ct. 1000 (1982). As recognized by the Court of Appeals, Congress determined that a high price for natural gas is an effective method of conservation. 1978 U. S. Code Congressional and Administrative News 8800, 8806. The price to be paid for natural gas by Northern to Amoco pursuant to Clause 6 (b) is the maximum lawful price permitted by the NGPA. The national public policy is not offended by the operation of Clause 6 (b). The Court of Appeals properly so found.

Northern's argument that the presence of the Wyoming Attorney General as *amicus curiae* in opposition to the validity of Clause 6 (b) is reflective of Wyoming's public policy, is nothing more than a bootstrapping ploy. It is the pronouncements of the Wyoming legislature and Wyoming's highest court which are dispositive on the public policy of the State.

The legislature of Wyoming, through its inaction, has clearly indicated that indefinite price escalator clauses are not violative

of Wyoming's public policy. In the NGPA, Congress extended to the states the invitation to enact further restrictions on the operation of indefinite price escalator clauses where such restrictions were deemed in the best interest of the state. As the Court of Appeals pointed out, some states have exercised their right to impose greater restrictions, but Wyoming is not one of them. The significance must be acknowledged.

Further, Northern's restrictive reading of *Amoco Production Company v. Stauffer Chemical Company*, 612 P.2d 463 (Wyo. 1980), cannot withstand analysis. The Wyoming Supreme Court, unconvinced by arguments of public policy, recognized the validity of favored nations clauses such as the one at issue herein.

> Favored nation clauses are a common feature of gas purchase and sale contracts. The nature of the product and its questionable availability engenders reluctance on the part of producers to enter into long-term contracts at the price prevailing at the time of the contract. Yet purchasers require long-term commitments to insure an adequate supply of gas . . . . A third party favored nation clause requires the purchaser to match any higher price contracted to be paid by any other buyer in the same field or area (citations omitted). Favored nation clauses are recognized by the courts . . . .
>
> The principle objective of such clauses is to escalate the agreed price to equal the ***highest*** price being paid for the commodity by any other purchaser.

Id. at 468.

The distinctions which Northern argues destroy the precedential value of *Stauffer* are not material to the decision. As recognized by the majority in *Superior Oil Company v. Western Slope Gas Company*, 604 F.2d 1281, 1291, n. 15 (10th Cir. 1979), "(t)he actual value of a product is determined by what people will pay for it, not by what it cost to produce." Pricing concepts such as vintaging, small producers' incentives and the like are irrelevant to the issues presented on appeal. *See Amoco*

Production Company v. Kansas Power & Light Company, 505 F. Supp. 628, 639 (D. Kan. 1980). The Court of Appeals below properly concluded that Clause 6 (b) does not offend the public policy of the State of Wyoming.

CONCLUSION

For the reasons stated above, the Petition for Certiorari should be denied.

Respectfully submitted,

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